

Testimony of

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On behalf of

Crop Insurance Research Bureau

Before the

House Committee on Agriculture

Subcommittee on General Farm Commodities

And Risk Management

TESTIMONY OF JAMES A. BROST

**Executive Vice President, Cooper Gay & Cashman, LLC
On behalf of Crop Insurance Research Bureau, Inc.**

Good afternoon. My name is James Brost. I serve as Executive Vice President for Cooper Gay & Cashman, a Reinsurance Intermediary that is located in Minneapolis, Minnesota. I am also a member of the board of directors of the Crop Insurance Research Bureau, on whose behalf I have the privilege to appear today and on whose behalf I testified before this committee in May of 2003.

The Crop Insurance Research Bureau (CIRB) is a not-for-profit trade association representing the interests of crop insurers, the reinsurance community, as well as others with an interest in the Federal Crop Insurance Corporation. CIRB's mission statement is "Working to Improve Crop Insurance through Unity and Leadership". It is in this spirit that I offer my remarks.

My role as a Reinsurance Intermediary is, in part, to entice reinsurers to provide their economic support to those companies writing Multiple Peril Crop Insurance (MPCI). And what is reinsurance? Reinsurance can be simply summarized as "insurance for insurance companies". Reinsurance helps protect an insurance company's capital base, or provide the insurance company with the capacity to write more business than what would normally be written based on that company's capital and surplus. Reinsurance may even provide operational income to the insurance company to assist in the delivery of the MPCI policy to America's producers. I believe it is fair to represent that commercial reinsurance has been, and will continue to be, vital to the continued success in the delivery of the MPCI program to America's producers.

The reinsurers' role in the MPCI program was initially brought to light during the early 2003 briefings with House and Senate staff members, and these same subcommittee hearings in 2003. The "commercial reinsurance" role had not really been widely known prior to this time, although it had always existed in the background.

Perhaps the key message at that time was: The Standard Reinsurance Agreement (SRA) is not the exclusive reinsurance vehicle utilized by most of the SRA holders; rather, - these SRA holders purchase "commercial reinsurance" from the private sector in order to better manage their expenses and protect their capital. This expense and capital protection and resulting continued viability of the SRA holder in delivering and servicing the MPCI policy, has been of keen interest to the Risk Management Agency (RMA) in the more recent past.

In recent years, many members of Congress and their respective staff have met people from the reinsurance industry who play an important role in MPCl. Today I am speaking on behalf of the Crop Insurance Research Bureau and its various reinsurance members. The views shared herein are mine, but I believe the comments are fairly representative of those of the reinsurance segment who write MPCl.

As inferred earlier, the reinsurers' role has been behind the scenes. Generally speaking, reinsurers do not have a direct dialogue with RMA over the various considerations within the MPCl program. Since they are not SRA holders, this is understandable. They are, however, stakeholders in the program and RMA, FCIC and members of Congress should be cognizant of the conditions that determine the reinsurer's support of MPCl.

Reinsurance is not unique to crop insurance. It is utilized by many carriers writing many different lines of insurance business. It is a basic premise that reinsurers expect to earn a profit on those classes of business where they provide reinsurance support. The Return on Equity (ROE) calculation is a measurement of the expected returns the reinsurer anticipates over a long period of time. This ROE calculation encompasses extensive analysis of the frequency and severity of estimated claim activity, policy premium income, estimated acquisition costs and the cost of capital deemed necessary to support the product line (there are many other factors also considered). The point made in 2003, and which continues to apply today, is that the reinsurance of MPCl insurance must remain competitive with other reinsurance product lines to attract reinsurance capital to the market. If the MPCl ROE falls below corporate expectations, then the industry and the federal government runs the risk of reinsurers exiting the product line. This would be detrimental to the MPCl program.

So how low must the ROE be to trigger an exit? I do not have a crystal ball capable of telling you what that magical ROE threshold figure is or should be. The overall industry target ROE floats up and down based on many, many factors. I do know, however, that as long as the MPCl program is competitive with other product lines, as we are today, we should anticipate continued deployment of reinsurance capital to the MPCl program. The concern, of course, is that the government will continue the trend of driving down the potential ROE from the crop insurance program.

Recent issues have evolved which the reinsurers have cast a watchful eye. Some of the more critical points are summarized below. Some points are driven by the Administration's 2007 proposed budget and some points are driven by RMA. All are important.

1. Continued reduction in the Administrative and Operating allowance (A&O):

The recent reductions invoked over the 2005 and 2006 programs have impacted the SRA holders' continued operational viability. Long term viability of an SRA holder's economic health is an essential aspect of a reinsurers' support of an SRA holder. While some of the recent reductions in A&O may have been partially absorbed by the reinsurers, this reduction in the A&O has also diminished the returns of some reinsurers. Therefore, the potential reduction in ROE invites the

discussion of how the reduced MPCl returns will compare to the other classes of business.

- 2. Potential increase in FCIC's share of the SRA holder's underwriting results:**
This "quota share" requirement of the 2005 SRA has had both a direct and indirect impact on reinsurers; it took business away from some reinsurers – a direct impact, - and it took potential income from the SRA holders – an indirect impact on the reinsurers. The 2005 business environment was the first year impacted by this quota share provision, with a potential for far greater impacts as proposed with the President's 2007 budget. Again, changes to the business environment can reduce or eliminate reinsurer support of the program, which will have a corresponding effect of decreasing the capacity of the current suite of SRA holders to adequately serve the MPCl market.
- 3. The Group Risk Income Protection Plan:** This policy uses a county index to trigger a potential claim payment to the crop producer. This means that crop producers with above average yields may nonetheless receive an indemnity payment if the general farming area has experienced yield reductions. This concept violates the very cornerstone of insurance principles – the requirement that an insured have an actual loss sustained to receive an indemnity payment. Conversely, a farmer who does suffer low yields in a county where averages are normal to above normal will not receive a payment making the safety net of crop insurance illusory. This policy should be considered an abuse of the MPCl program. It encourages adverse selection against the crop insurance program and undermines its integrity. The adverse premium and loss results of this product underscore the need to address this product.
- 4. A fee from SRA holders for Information Technology (IT) modernization:**
The Administration's proposed budget seeks a "user fee" from SRA holders. This is simply a tax on the SRA holders; a flat expense that will unduly threaten the economic health of every SRA holder. If you will recall, the economic health of the SRA holder is a key consideration to a reinsurer before providing their reinsurance support. It is apparent and has been for sometime, RMA has needed to modernize its IT system. Continued failure to address this problem weakens the program; however, it is patently unfair to finance this project on the backs of the delivery system whose own systems are stretched because of outdated government technology.
- 5. Premium Reduction Plan (PRP):** The reinsurance community continues to voice concern with PRP. The PRP plan may encourage an SRA holder to cut costs in areas that could be detrimental, in the long and short terms, to the sound administration and integrity of the MPCl program.
- 6. Data Mining:** One of the most encouraging initiatives that holds a great deal of promise in addressing fraud and abuse is data mining. This allows RMA to

identify anomalies and alert the SRA holder of program irregularities for closer review. It is essential that its continued funding be secured and we encourage this committee to support further development and refinement of this initiative.

The last two crop seasons have produced attractive underwriting results for the reinsurance industry. These positive returns are necessary to level losses from years gone by and to manage large financial losses in future years when there is widespread drought or flood causing catastrophic crop losses. The MPCIR reinsurance industry is positioned to absorb whatever Mother Nature throws at them when it's their turn.

Again, many thanks to the committee and its members for the opportunity to appear before you today. If appropriate, I would be delighted to answer any questions you may have.